Internal Revenue Service

memorandum

CC:TL-N-10521-87
Br1:CEButterfield

date: OCT 2 1 1987

to: District Counsel, San Diego CC:SD

from: Director, Tax Litigation Division CC:TL

subject: [redacted]

You requested additional technical advice in the [redacted] case, by memorandum dated September 11, 1987.

Conclusion

It would not be advantagious to offer a settlement in [redacted] on the reasonable litigation cost issue. Despite the risks of litigating this case and the related cases in the shelter project, our exposure even in settlement justifies continued litigation of the issue. The Tax Court lacks jurisdiction to consider a request for attorneys' fees based solely on improper collection activity. Moveover, given that the collection activity has abated, there is no live controversy to convey jurisdiction to the District Court. No Code provision provides an award of attorneys' fees under these circumstances. Neither do we believe that the confusion from the unclear motion to dismiss [redacted] second petition causes the Service's position to be less than substantially justified, as would be required under I.R.C. § 7430, as amended by the Tax Reform Act of 1986..

Facts

Petitioner received a notice of deficiency for her [redacted] tax year, dated [redacted]. Petitioner deposited $[redacted] in the nature of a cash bond and, on [redacted], filed a petition in Tax Court, Docket Number [redacted]. In spite of the filing of this petition, the Service issued a collection notice to petitioner dated [redacted], requesting payment of $[redacted] within 10 days. Petitioner requested that the collection action be abated, and subsequently, on [redacted], requested that $[redacted] of the bond previously posted be treated as a tax payment.

The Service issued a second notice of deficiency for the tax year [redacted], on [redacted]. Petitioner was included in a petition in response to that notice, Docket Number [redacted]. The Service moved to dismiss this docket number, which number

included numerous petitioners from the tax shelter project. The Service then clarified that only the [redacted] petition should be dismissed, on the grounds that the notice of deficiency on which it was based was invalid.

[redacted] case was thereafter severed by the court and renumbered. The court stated that it would consider the motion to dismiss and requested that any motion for costs and attorneys' fees be filed before [redacted]. Petitioner then filed the motion for costs and attorneys' fees.

Legal Analysis

Section 7430 allows the court to award fees and costs to successful petitioners in civil actions under the Code. In order to be entitled to an award the petitioner must show that the government's position was unreasonable, or, for post-1986 actions, not substantially justified. A recent Tax Court case has found these two standards to be equivalent, Sher v. Commissioner, 89 T.C. No. 9 (July 9, 1987). The court in Sher relied in part on pre-1985 Equal Access to Justice Act (EAJA) cases. However, when the EAJA was amended in 1985, the definition of substantial justification as requiring more than mere reasonableness was clarified. H.R. Rep. no. 120 at 9, 1985 U.S. Code Cong. and Ad. News at 138. Thus we do not rely on the finding of equivalence by the Tax Court, because we do not believe it is correct.

Section 7430 also requires that all administrative remedies must be exhausted before costs and fees may be requested and places a limit of $75 per hour on attorney's fees.

Petitioner would be deemed to have exhausted the administative remedies available within the Internal Revenue Service. See Treas. Reg. § 301.7430-1(f)(3)(ii). We do not believe, however, that section 7430 authorized an award on these facts. Section 7430 is intended to allow fee awards in civil actions where the position of the government, after the petition is filed, is not substantially justified, unless under section 7430 as amended by the Tax Reform Act of 1986 there were administrative action or inaction by the District Counsel of the Internal Revenue Service. Sher, 89 T.C. No. 9. The Tax Court has no jurisdiction to grant attorneys' fees for collection activity unrelated to a civil action over a deficiency. Moreover, to the extent that the court has jurisdiction to make an award for the costs incurred in filing and dismissing the second petition, we would assert that our position after the filing of the petition, that the case should be dismissed, was substantially justified, even though it took some time to effectuate.

The Tax Court is a court of limited jurisdiction. Masat v. Commissioner, 784 F.2d 573 (5th Cir. 1986). Sections 6212 and

6213 establish the limitations within which the court operates. The Rules of Practice and Procedure, Rule 13, state that the jurisdiction of the court is generally limited to cases commenced on the issuance of a notice of deficiency. The Tax Court is not empowered to resolve disputes arising out of collection activities. Generally, actions to enjoin collection activity are prohibited by section 7421. The remedy for allegedly improper collection activity is a petition to the Secretary for an abatement, as was made in this case, or suit in District Court. The collection in this instance was abated as soon as was practicable, and before an action for refund was brought. There is currently before the Congress a proposal to grant the Tax Court power to enjoin collection activity on matters pending before it. At present, however, no such authority exists.

There are two essential elements to our argument in this case. First, the collection activity was in no way related to either of the petitions pertaining to [redacted] tax year, thus no jurisdiction is conveyed to the court to award attorneys' fees for costs incurred in abating the collection. (Even if the collection activity could be deemed to bear sufficient relationship to the first petition, that matter is still pending before the Tax Court, so a motion for costs and fees would be premature at this time. Section 7430(e).) Second, the government's position regarding the second petition was substantially justified.

An award of attorneys' fees against the government is the result of a waiver of sovereign immunity. Therefore any statute authorizing the award of attorneys' fees must be strictly construed in favor of the sovereign. Where Congress did not clearly authorize an award, no elaboration by the courts on the statutory scheme is permitted. Ruckelshaus v. Sierra Club 463 U.S. 680 (1983); Ewing and Thomas, P.A. v. Heye, 803 F.2d 613 (11th Cir. 1986). The award of fees authorized by section 7430 was intended to be limited to fees and costs incurred in the pursuit of successful civil litigation against the government. It makes no provision for an award of costs incurred during the resolution of administrative confusion, no matter how extensive. Sher. Any award of costs by the Tax Court must be limited to costs incurred in the successful prosecution of a petition properly brought before it.

We note that in this case an argument could also be made that the Tax Court has no jurisdiction to make an award for a petition that it dismissed. The Tax Court originally accepted this view in Fuller v. Commissioner, T.C.M. 1986-33. The Tax Court again addressed this question in Weiss v. Commissioner, 88 T.C. No. 57 (1987). The Tax Court reversed itself and stated that "[w]e believe that Congress has given us authority to resolve all questions related to the issue of our jurisdiction, including ancillary matters such as an award of

attorney fees." The question of jurisdiction itself is one over which the court originally had jurisdiction, and, provided the motion for fees is filed in a timely fashion, the court may consider it as part of the determination they are empowered to make.

Given that the determination of the existence of jurisdiction is a question properly before the court, the Tax Court has still limited its view of what issues may be resolved in connection with such a question. Thus, on the issue of whether or not the Tax Court may consider collection activity, or other administrative action that predates the filing of a petition in Tax Court, the court has limited its inquiry to post-petition events. Even before the 1986 amendments, the Tax Court's position on the issue of administrative conduct is that only the post-filing position of the Service may be considered. Baker v. Commissioner, 83 T.C. 822 (1984), vacated and remanded on other grounds, 787 F.2d 637 (D.C.Cir. 1986); Don Casey Co. v. Commissioner, 87 T.C. 847 (1986).

In the most recent pronouncements under the amended section 7430, the court has indicated a conservative approach. In Sher, the court disregarded administrative errors, and considered only that once the District Counsel attorney became aware of and involved in the case, the actions necessary to resolve the administrative mishaps were taken. That the matter could have been resolved administratively before the filing of the petition was considered irrelevant. Only the actions of the District Counsel attorney, and the administrative actions taken after he became involved, were considered in denying the fee award. The reasoning in Sher is applicable to the case at hand, where once the District Counsel attorney became involved he took immediate steps to dismiss petitioner from the second petition. Under the Sher reasoning, there would be no authority for the Tax Court to make an award based on the costs of getting the intervening collection action abated either, as those costs were not incurred in response to an unreasonable position taken by the District Counsel attorney in litigation (relating to either the first or second petition.

Along similar lines is the decision reached by the court in Shifman v. Commissioner, T.C.M. 1987-347. There the court limited its review to actions taken by the District Counsel attorney after he became involved in the case. Administrative activity preceding his involvement was considered outside the allowable scope of examination. The attorney in Shifman took immediate steps to concede the deficency after the filing of the petition. Another memorandum opinion, Rouffy v. Commissioner, T.C.M. 1987-5, took the same view. That case dealt only with the question of whether the time that elapsed before the District Counsel attorney conceded the case was unreasonable.

What had gone before, in Examination or Appeals was considered irrelevant to the 7430 inquiry. So we would assert in this case that the District Counsel acted reasonably after the filing of the second petition, and that 7430 does not allow fees to be awarded for administrative actions not related to a matter before the Tax Court (i.e. the collection activity that transpired between the filing of the two petitions).

Were this case to go before a court of appeals, additional precedents would have to be considered. There are several circuit court cases interpreting the intended breadth of a proceeding for 7430 purposes. Several of the circuits, in pre-1986 cases, have incorporated pre-petition administrative activity in their deliberations of the fee question. Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985); Powell v. Commissioner, 791 F.2d 385 (5th Cir. 1986). These cases may have continuing validity after the 1986 amendments. Hill et al. v. United States, 87-1 U.S.T.C. 9297 (U.S. Bk. Ct., D. Colo. 1987); Plowman v. United States, 659 F. Supp. 34 (W.D. Oklahoma 1987). To our detriment in this case, it must be noted that there are several circuits that take the position that unreasonable administrative actions that virtually force a taxpayer to file a petition may properly be considered part of the proceeding, and may serve as a basis to evaluate the reasonableness of the government's position. Tax Analysts v. United States, 60 A.F.T.R.2d 87-5061 (Ct. Cl. 1987) involved an exempt organization which was assessed a penalty and interest because the Service claimed that their form 990 had not been timely filed. In fact, the record established that the form had been timely filed, and had been mislaid or destroyed by Service employees. The erroneousness, and unreasonableness of the Service's position in asserting the penalty was based on the administrative misfeasance that had gone before, forcing the taxpayer to seek a refund in a civil proceeding.

Obviously, we are mindful of the considerable litigation risks in this case. We must urge a narrow reading of the court's authority to consider fee requests, and a narrow definition of matters related to a properly docketed proceeding. We must assert that the collection activity was unrelated to the petition filed, which is an assertion the court may be extremely reluctant to adopt given the odious facts of this case. However, by litigating this case we open the possibility to create a favorable precedent, circumscribing the application of section 7430 in cases when counsel has behaved reasonably, and the only errors were committed by administrative functions. It is necessary for us to attempt to pursuade the Tax Court that collections activity, even arising out of tax years properly before it, will not convey jurisdiction to make an award under section 7430. We believe this to be a pursuasive argument, based on the restrictive language of the section, and the limitations on the Tax Court's jurisdiction.

There is no question that our interpretation will yield a harsh result in this case. However, there is no provision for an award in compensation for costs incurred in abating improper collection activity by the Tax Court, and section 7430 should not be expanded to create one. Therefore, we recommend no settlement of the motion for attorneys' fees in this case.

You also inquired whether any limitation could be applied to the amount of an award, if one were made, because of the membership structure of the partnership, and the limited cost to each member for attorneys' fees. We have found no case that specifically addresses this point. The legislative history to the Equal Access to Justice Act discusses the issue of available assets, in the context of labor organizations. The history makes it clear that local unions will be considered eligible for an award of attorneys' fees under the EAJA without reference to the net worth of the international to which they belong. Analogous considerations might be applicable to an organization such as the one to which petitioner belongs. H.R. Rep. No. 120 at 17, 1985 U.S. Code Cong. and Ad. News at 145-146. Moreover, it is our position that the net worth limitation will be applied on an individual basis, regardless of the fact that the individual belongs to a partnership, even in a TEFRA partnership proceeding.

Most of the petitioners in this shelter project who may be filing motions for attorneys' fees were docketed in 1986, making the $75 per hour cap applicable. There are certainly some additional limits on the amount that can be awarded, even for pre-1986 cases. Documentation is required to demonstrate to the satisfaction of the court that the amounts claimed were actually expended, and that such expenditures were reasonable. Johnson v. United States, 578 F. Supp. 226 (S.D.N.Y. 1984). The redundancy of research involved in the various motions that may eventually be filed should operate to limit the amount of fees that can reasonably be awarded. There is a dearth of cases detailing exactly what the reasonable limits are under section 7430, in a case of this nature.

If you have any further questions on this matter, please do not hesitate to call Ms. Clare E. Butterfield, at FTS 566-3521.

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